RATING REPORT

NRSP Microfinance Bank Limited

REPORT DATE:
May 05, 2020

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A	A-1	A	A-1
Rating Outlook	Rating Watch – Negative		Stable	
Rating Date	*April 30th, '20*		*April 30th, '19*	

COMPANY INFORMATION

Incorporated in 2008	**External auditors:** M/s A. F. Ferguson & Co., Chartered Accountants, a member firm of the PwC network
Public Limited Unlisted Company	**Chairman of the Board**: Dr. Rashid Bajwa **Chief Executive Officer**: Mr. Zahoor Hussain Khan
Key Shareholders (with stake 5% or more):	
National Rural Support Program (NRSP) – 52.06%	
International Finance Corporation (IFC) – 16.02%	
KfW – 15.91%	
Acumen Fund – 10.67%	
Acumen Capital Markets – 5.34%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Micro Finance Banks (June 2019)
https://www.vis.com.pk/kc-meth.aspx

NRSP Microfinance Bank Limited

OVERVIEW OF THE INSTITUTION

NRSPB is licensed by SBP to operate as a nationwide microfinance bank under the Microfinance Ordinance, 2001. The bank provides microfinance services to the rural low income sector with an overall objective of mitigating poverty and promoting social welfare.

Profile of Chairman

Dr. Rashid Bajwa is the current Chief Executive Officer (CEO) of the National Rural Support Program (NRSP). Mr. Bajwa also holds various honorary positions such as Director of Pakistan Microfinance Network, Member of State Bank of Pakistan's committee of Rural Finance and Sindh Rural Support Program.

Profile of CEO

Mr. Zahoor Hussain Khan serves as the President/CEO of NRSPB, where he has led the whole transformation process of NRSP Bahawalpur Region's microfinance operations into a fully regulated and licensed NRSPB. He has vast experience of designing, planning, monitoring, policy formulation and product development for rural microfinance.

Financial Snapshot

Total assets: 1QFY20 – Rs. 40.5b FY19 – Rs. 40b.

RATING RATIONALE

The assigned ratings of NRSP Microfinance Bank Limited (NRSPB) incorporate presence of reputable sponsors carrying reasonable experience and understanding of the microfinance sector. Sponsor's commitment has been demonstrated in the recent years in the form of both technical and financial support. VIS anticipates this support to continue in case the need arises. The ratings take into account continued augmentation of loan book mainly on the back of enhanced network and higher average loan size. Asset quality indicators remained under pressure during the year on account of higher incidence of non-performing loans as the bank predominantly operates in the agriculture sector, leading to significant decline in profitability. A decline in liquidity and capitalization indicators was also witnessed during the period. Issuance of Tier-II capital while enhancing Capital Adequacy Ratio, will also help in loan book growth.

Key Rating Drivers

Slight acceleration in business growth led by increase in average loan size and higher disbursements: Gross loan portfolio of the bank increased to Rs. 27.4b during FY19 (FY18: Rs. 23.3b) mainly on account of slightly higher disbursements and growth in average loan size, despite decline in number of loans disbursed and active borrowers. The bank reduced concentration of agri inputs loans in order to curtail the mounting pressure of NPLs. In line with the bank's overall strategy of growth in higher sized loans, the width of product portfolio was enhanced with the launch of Fori-Makaan financing.

Asset quality indicators remained under pressure: Asset quality indicators of the bank remained under pressure during FY19 owing to slow economic growth, rising inflation, and issues pertaining to yield, pricing and purchase of agriculture produce. All of these factors negatively impacted the income stream and repayment capacity of the farmers. Moreover, over-indebtedness of farmers in the Southern Punjab region, as a result of significant increase in number of branches by microfinance banks in the last two years, also contributed towards increased instances of defaults. While gross and net infection ratios decreased to 1.62% (FY18: 2.72%) and 1.12% (FY18: 1.73%) respectively, incremental infection remained on the higher side at 6.3% (FY18: 6.5%) on account of higher loan write-offs amounting Rs. 1.9b (FY18: Rs. 917m). Gross and net infection stood higher at 3.1% and 1.9%, respectively, at end-1QFY20.

Given the current scenario concerning the global Coronavirus disease pandemic and lockdown situation, asset quality indicators may remain stressed in FY20 as well. Meanwhile, the management has taken some initiatives to curtail infection and improve recoveries, including shift in focus from agriculture lending to MSME and livestock segments. Going forward, the bank intends to increase the proportion of secure lending products and EMI-based MSME products, especially housing and loans against gold as collateral. Besides occasional in-person visits, dedicated teams are deployed at regional level for monitoring and telephonic follow-ups of problematic clients.

Lower profitability due to increased provisioning and lower spreads: Profit before tax of the bank plummeted to Rs. 87m (FY18: Rs. 899m) mainly on account of largely flat net markup income, sizeable increase in loan loss provisions to Rs. 1.8b (FY18: Rs. 1.1b) and higher administrative expenses. Moreover, operation self-sufficiency of the bank decreased to 101% (FY18: 114%). Cost of funds was recorded higher in the midst of increasing interest rate environment. Increase in yield on markup bearing assets was led by higher return on investment and placements with financial institutions. Given increase in cost of funds, markup spread stood lower at 12.1% during FY19 (FY18: 13.2%) as the bank also maintained competitive pricing on advances during the year. Profit after tax amounted to 263m during 1QFY20 with improved mark-up spread of 14.1% due to increase in markup rate on some agri and EMI-based loan products. Fee, commission and brokerage income was also recorded higher in 1QFY20 as the bank aligned its loan processing and other banking services fees with the peers.

Weakened liquidity and capitalization indicators: Deposits remained the primary source of lending activities during the year. Total deposits increased marginally on account of uptick in number of accounts as the bank discouraged high-cost deposits. Slight improvement in deposit mix occurred with increase in the share of CASA deposits, as some fixed deposits were shed to rationalize cost of funds. Some moderation in concentration risk was noted on account of decline in share of top-50 depositors to 49.9% (FY18: 61.9%) by end-FY19. Some comfort can be drawn by the fact that related-parties constituted 29.5% (FY18: 30.1%) of

Total equity:
1QFY20 – Rs. 5.0b
FY19 – Rs. 4.7b.

top-50 deposits. Going forward, the management intends to increase granularity by introducing small-sized deposits mainly through expansion of branchless banking operations. Due to partial utilization of surplus liquidity towards financing activities, liquid assets-to-total deposits & borrowings stood lower at 22.6% at end-FY19 (FY18: 34.3) while advances-to-deposits ratio increased to 102.7% (FY18: 88.8%).

Net profit:
1QFY20 – Rs. 263m
FY19 – Rs. 84m.

Equity base of the bank stood at Rs. 4.7b at end-FY19 (FY18: Rs. 4.6b). Net NPLs in relation to tier-1 capital stood at 6.6% at end-FY19 (FY18: 8.9%). CAR of the bank decreased to 15.4% (FY18: 16.6%), slightly above the minimum regulatory requirement of 15%, mainly on account of increase in risk-weighted assets. The bank plans to mobilize new borrowings of up to Rs. 1.5b during FY20, including Rs. 500m through a running finance facility and Rs. 1b through Term Finance Certificates (TFC) as Tier-II capital in order to enhance capital adequacy.

NRSP Microfinance Bank Limited Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*				
BALANCE SHEET	**Dec 31, 2017**	**Dec 31, 2018**	**Dec 31, 2019**	**Mar 31, 2020**
Cash & balances with SBP and NBP	1,643	1,121	1,483	1,085
Balances with other Banks/NBFIs/MFBs	5,223	3,699	3,967	2,707
Net Investments	2,696	3,459	1,590	1,440
Net Financing	20,706	23,311	27,371	29,178
Other Assets	3,321	6,761	5,593	6,082
Total Assets	33,590	38,351	40,005	40,492
Total Deposits	23,672	26,263	26,651	26,799
Borrowings	3,966	5,204	4,437	4,474
Other Liabilities	1,938	2,275	4,230	4,264
Tier-1 Equity	4,012	4,598	4,684	4,947
Net Worth	4,014	4,608	4,688	4,954
Paid-Up Capital	1,498	1,498	1,498	1,498
INCOME STATEMENT	**Dec 31, 2017**	**Dec 31, 2018**	**Dec 31, 2019**	**Mar 31, 2020**
Net Mark-up Income	2,937	4,105	4,122	1,243
Net Provisioning / (Reversal)	384	1,125	1,820	361
Non-Markup Income	871	833	1,165	380
Operating Expenses	2,315	2,885	3,355	880
Profit Before Tax	1,106	899	87	379
Profit After Tax	821	591	84	263
RATIO ANALYSIS	**Dec 31, 2017**	**Dec 31, 2018**	**Dec 31, 2019**	**Mar 31, 2020**
Gross Infection (%)	0.3	2.7	1.6	3.1
Incremental Infection (%)	1.9	6.5	6.3	2.1
Provisioning Coverage (%)	31.2	36.8	31.5	40.4
Net Infection (%)	0.2	1.7	1.1	1.9
Net NPLs to Tier-1 Capital (%)	1.2	8.9	6.6	11.1
Capital Adequacy Ratio (%)	18.4	16.6	15.4	15.5
Cost of Funds (%)	8.1	7.8	11.1	12.5
Markup Spreads (%)	15.1	13.2	12.1	14.1
OSS (%)	116.6	114	101	n.a
ROAA (%)	2.7	1.6	0.2	2.6
ROAE (%)	22.8	13.7	1.8	21.8
Liquid Assets to Total Deposit & Borrowings (%)	34.6	34.3	22.6	16.7

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure I

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Annexure III

Name of Rated Entity	NRSP Microfinance Bank Limited
Sector	Micro Finance Bank
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
30-04-2020	A	A-1	Rating Watch Negative	Maintained
14-May-2019	A	A-1	Stable	Reaffirmed
27-Apr-2018	A	A-1	Stable	Reaffirmed
30-Oct-2017	A	A-1	Stable	Reaffirmed
03-May-2017	A	A-1	Stable	Reaffirmed
28-Oct-16	A	A-1	Stable	Upgrade
RATING TYPE: INSTRUMENT				
27-Apr-2018	A			Reaffirmed
30-Oct-2017	A			Reaffirmed
03-May-17	A		Stable	Reaffirmed
28-Oct-16	A		Stable	Upgrade
21-Sep-16	A-		Stable	Final
14-June-16	A-		Stable	Preliminary

Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Amjad Iqbal Khan	Business Head	14th Apr'20
Mr. Tanveer Hussain	Head of Operations	14th Apr'20
Mr. Asif Mahmood	Head of Finance	14th Apr'20
Mr. Muhammad Waqas Ashraf	Head of Risk/Compliance	14th Apr'20